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IN THE

Supreme Court of the United States

October Term, 1964

No. 140

ISADORE BLAU,

Petitioner,

vs.

DAVIS FACTOR; LOUIS FACTOR; MAX FACTOR, JR.; SIDNEY FACTOR; CHESTER FIRESTEIN; MAX FIRESTEIN; FREDA F. SHORE; ANNA FACTOR; DORIS FACTOR; DOROTHY FACTOR; CECILIA FIRESTEIN, and MAX FACTOR & CO.,

Respondents.

PETITION FOR WRIT OF CERTIORARI.

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1 Fletcher, Cyclopedia of Corporations, Sec. 5086, p. 56 5

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioner, Isadore Blau, a stockholder of Max Factor & Co., respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, rendered February 24, 1965 [R. 152, *infra*, App. p. 3], which affirmed the judgment of the United States District Court for the Southern District of California, Central Division [R. 143], dismissing the complaints and cross-complaint against the individual respondents herein.

Opinions Below.

The District Court did not render any opinion in the actions. Its Findings of Fact and Conclusions of Law [R. 137] were not officially reported. The opinion of the Court of Appeals [R. 152, App. p. 1] has not yet been reported.

Jurisdiction.

The judgment of the Court of Appeals [R. 152, App. p. 1] was entered on February 24, 1965.

Jurisdiction is conferred upon this Court by 28 U.S.C., Section 1254(1).

Question Presented for Review.

Where insiders of a listed corporation, owning more than a majority of its voting stock and constituting more than a majority of its Board of Directors and Officers, *voluntarily* convert their *long-term investment* in the corporation's *unlisted* shares of stock into *listed, dividend preferred* shares which are then sold by them at a profit within less than six months,—are such acquisitions of the listed, dividend preferred shares "purchases" within the meaning and purpose of Sections 16(b) and 3(a)(13) of the Securities Exchange Act of 1934, 15 U.S.C.A., Secs. 78p(b) and 78c(a)(13)?

Statutes and Regulations Involved.

Pertinent provisions of the Securities Exchange Act of 1934, Sections 16(a),16(b) and 3(a)(13), 15 U.S.C.A., Sec. 78p(a), p. 46 Cum. Sup., Sec. 78p(b), p. 322, and Sec. 78c(a)(13), p. 235, are set forth in the Appendix, *infra*, p. 1.

Statement of Facts.

The action was brought by petitioner, Blau, as a stockholder of Max Factor & Co., (hereinafter referred to as the "Issuer"), pursuant to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C.A., Sec. 78p(b), to recover the short-swing profits realized by the individual respondents from their respective purchases and sales of the Issuer's listed securities within periods of less than six months.

The basis for jurisdiction of the United States District Court for the Southern District of California is Section 27 of the Securities Exchange Act of 1934, 15 U.S.C.A., Sec. 78aa.

Each of the individual respondents is related to the others by blood or marriage, and, together with other members of their families, Trusts and a Foundation controlled by them, own or control approximately 75% of the Issuer's voting stock, and constitute more than a majority of its Board of Directors, officers and members of its Executive Committee [R. 29, 32, 118].

During all the material times here involved each of the individual respondents was a director, officer or beneficial owner of more than 10% of the Issuer's listed securities [R. 29, 32, 118].

The Issuer's capital stock is divided into two separate and definitive classes, designated as "Common Stock" and "Class A Stock," respectively [R. 80, Ex. A, p. 3].

The individual respondents herein, together with the members of their families and various Trusts and a Foundation controlled by them, have at all time since 1947 owned substantially all of the Issuer's outstanding shares of Common Stock [R. 105, 119].

The Common Stock has never been listed upon any national securities Exchange and has never been registered nor exempted from registration under the Securities Act of 1933 [R. 116, 117].

The shares of the Issuer's Class A Stock, on the other hand, were listed on The American Stock Exchange until April 18, 1961, and have been listed since that date on the New York Stock Exchange, and have been actively traded by the general public [R. 116].

The powers, rights and preferences of each of the aforesaid classes of stock are set forth in the Issuer's Certificate of Incorporation, and are substantially as follows [R. 80, Ex. A, p. 3].

(a) Each Class is entitled to one vote per share, and voting is not by separate classes "except where specifically so required by law."

(b) The right to the payment of dividends is not cumulative with respect to either Class, but the holders of the *Class A Stock* are entitled to dividends "in preference and priority to any payment of any dividend on Common Stock." Moreover, it is only *"after* a dividend * * * has been so paid or declared and set apart for payment on the *Class A Stock,"* that a dividend "equal to or less than such dividend" may be declared and paid on the shares of Common Stock. The cash dividends paid upon the shares of *Class A Stock* have always been substantially greater than the dividends paid on the shares of Common Stock [R. 115].

(c) Although the unlisted shares of Common Stock were convertible at the holder's option into listed Class A Stock on a share for share basis, the Issuer's Board of Directors was authorized to adopt a resolution at any

time *requiring* "that the Class A Stock be exchanged share for share for Common Stock." This latter provision, coupled with its right to a dividend preference, clothed the Issuer's *Class A Shares* with all the attributes of a "Callable Preferred" Stock.*

Sometime during December, 1960, initial conferences were held between the representatives of certain underwriters and the individual respondents herein regarding the latter's sale to the public of 200,000 shares of the Issuer's *Class A Stock*. The agreement ultimately reached provided that the initial offering price of such shares would be fixed and determined by mutual agreement "not higher than the last reported sales price (regular way) * * * on The American Stock Exchange immediately prior to such determination." Such offering price of the Class A Stock was finally fixed at $56.75 per share [R. 121].

In order to be in a position to sell the Issuer's *Class A Stock* pursuant to their contemplated public offering thereof, the individual respondents *voluntarily* converted 200,000 shares of their *Common Stock* into a like number of *Class A* shares on March 14, 1961. The price on that date of the *Class A Stock* ranged between $41-$44 7/8 per share [R. 119].

Approximately one month thereafter, on April 18, 1961, the individual respondents sold the 200,000 shares of Class A Stock, receiving the net sum of $53.80 per share therefor [R. 106].

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*"Corporations sometimes issue different classes of so-called 'common stock', often called Class A and Class B. * * * If the distinction between the classes * * * is not in voting rights but in priority or amount of participation in earnings or assets, the class that has priority is really a participating preferred stock as against the other class." *Fletcher, Cyclopedia of Corporations*, Sec. 5086, p. 56 (Perm. Ed. 1958, Rev. Vol. 1).

During the first quarter of 1961, the individual respondents herein, constituting a majority of the Issuer's Board of Directors, caused the Issuer to declare the regular 20¢ cash dividend on its shares of Class A Stock *plus an extra 4% stock dividend thereon* [R. 115].

During the one month period, between which the individual respondents converted their Common Stock and sold the Class A shares acquired thereby, the prices at which the Class A shares were traded on The American Stock Exchange skyrocketed from $41 to $61 per share, a spread of 20 points or 49%. In fact, at the end of this one month period, its market price was approximately $18 per share *higher* than at the beginning, an *increase* of 41.5% [R. 131-133].

In contrast to such an extraordinary price pattern, and during the same one month period, the market prices of the shares of four other companies, engaged in the same business as the Issuer, similarly listed on The American Stock Exchange, having market ratings equally as good or better than the Issuer's Class A Stock and selling within a similar price range, showed a spread of between 5 to 8 1/2 points per share, or only 9%-19.4%. Moreover, at the end of this one month period the market prices of the shares of each of these four comparable companies actually *decreased* between 2%-4% from their initial price range at the beginning of such period [R. 131-133].

The District court granted the individual respondents' motions for summary judgment and dismissed the complaint without opinion. In its findings, that court held that, (a) the individual respondents' acquisitions of the Issuer's shares of Class A Stock by converting their

Common Stock therefor "do not constitute 'purchases' within the purpose and meaning of Section 16(b) of the Securities Exchange Act of 1934", and (b) the individual respondents "did not, within the purpose and meaning of Section 16(b) * * * 'realize' any profit from any 'purchase and sale' * * * by reason of the exchanges by them of Common Shares for Class A Shares, followed by the sale of Class A Shares" within less than six months.

The Court of Appeals affirmed.

Reasons for Granting the Writ.

1. The Court of Appeals for the Ninth Circuit has decided an important question of federal law which has not been, but should be settled by this Court. The interpretation of the federal statute by the Court of Appeals finds no sanction in the statute and is in conflict with the stated Congressional purpose and intent which prompted its enactment.

2. The decision by the Court of Appeals for the Ninth Circuit, that an insider's conversion of his *long-term investment* in an Issuer's shares does not constitute a "purchase" of shares *acquired* thereby, conflicts with the decisions in *Park & Tilford, Inc. v. Schulte* (2 C.A.), 160 F. 2d 984, *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255, and *Booth v. Varian Associates, Inc.* (1 C.A.), 334 F. 2d 1.

ARGUMENT.

I.

The Court Below Has Decided an Important Question of Federal Law Which Has Not Been, but Should Be, Settled by This Court.

The stated congressional purpose for enacting Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C.A., Sec. 78p(b), was

> "preventing the unfair use of information which may have been obtained by such beneficial owner, director or officer by reason of his relationship to the issuer."

In enumerating its reasons for enacting such legislation and stating the evils sought to be corrected thereby, Congress pointed out the imperative need to regulate and control "transactions by officers, directors and principal security holders * * * to insure the maintenance of fair and honest markets in such transactions" because "frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control * * * resulting in sudden and unreasonable fluctuations in the prices."[1]

In seeking to discourage such activities, "congress sought to take the profit out of what it considered improper conduct"[2] by requiring insiders of listed corporations to disgorge any profits realized from their purchases and sales of its securities within any period of less than six months. Although this statutory deterrent against insider trading initially encompassed only those issuers whose securities were listed upon a

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[1]Section 2, Securities Exchange Act of 1934, 15 U.S.C.A., Sec. 78(b).

[2]*Adler v. Klawans* (2 C.A.), 267 F. 2d 840, 844.

national securities exchange, such limited protection was found to be so vitally important to the general body of public investors that Congress recently extended its applicability to certain issuers having no securities listed upon any national exchanges.[3]

In order more fully to accomplish the legislative purpose against such insider-trading, Congress expressly *broadened* the ordinary definition of "purchase" so that it would include "*any contract* to buy, purchase, *or otherwise* acquire",[4] thus evidencing its intention that "purchase" and "acquisition" be used interchangeably.

Since the individual respondents' ownership of their Issuer's unlisted Common stock carried with it an option to convert such shares into the listed Class A Stock, this conversion option was in fact a "contract to * * * otherwise acquire" the latter shares, and thus fell squarely within the statutory definition of "purchase".

Moreover, an insider's short-swing trading on the basis of options was one of the primary evils against which Section 16(b) of the Act was aimed. Congressional investigations clearly disclosed that "many of the most flagrant abuses upon stock exchanges would not be possible without the aid of options", and that "they are indispensable concomitants of every pool operation designed to distribute stock at an increased price".[5] The insider's use of options "has been found

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[3]Sections 12(g) and 16(a), Securities Exchange Act of 1934, as amended in 1964; 15 U.S.C.A. Secs. 78-1(g) and 78p(a), as amended in 1964.

[4]Section 3(a)(13), Securities Exchange Act of 1934, 15 U.S.C.A., Sec. 78c(a)(13).

[5]Senate Report No. 792 on Federal Securities Exchange Act of 1934 (1934), 73d Cong., 2nd Sess., p. 9.

to be at the bottom of most manipulative operations" because it "permits large-scale manipulations to be conducted with a minimum of financial risk", and, "as it is not always easy to trace and prove manipulative activity, it is necessary to rid the market of devices which commonly accompany or cloak these activities."[6]

In view of such unequivocal evidence of Congressional intent against an insider's use of options, conversions and similar devices as an aid to his short-swing transactions in his issuer's securities, "and in order to give maximum support to the statute, courts have attempted to include these transactions by characterizing them as purchases or sales", and "this has led to inconsistent results in the decisions, * * * and conflicting views among the commentators."[7]

In attempting to formulate a yardstick in determining whether an insider's conversion of his issuer's stock constitutes a "purchase" of the shares acquired thereby within the purpose and intent of Section 16(b), the courts have applied the standard that a "transaction is a 'purchase' if *in any way* it lends itself to the accomplishment of what the statute is designed to prevent",[8] or, if it "can *possibly* lend itself to the speculation encompassed by Section 16(b)."[9]

Although the application of such legal standards to the facts of this case demanded a determination by the Court of Appeals that the individual respondents' vol-

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[6]House of Representatives Report No. 1383 (1934) on Securities Exchange Bill of 1934, p. 10.

[7]*Booth v. Varian Associates, Inc.* (1 C.A.), 334 F. 2d 1, 4.

[8]*Blau v. Lehman* (2 C.A.), 286 F. 2d 786, 792, aff'd 368 U.S. 403.

[9]*Ferraiolo v. Newman* (6 C.A.), 259 F. 2d 342, 344-345.

untary conversions of their Issuer's unlisted Common Stock constituted "purchases" of the listed Class A shares acquired thereby, the Court refused to do so. The basis of its decision was predicated upon the fact that, since the individual respondents had owned the Issuer's unlisted Common Stock for many years, their conversions of such stock "conferred no opportunity for speculative profits which the appellees did not already enjoy", and they "made only one investment decision in the six months' period — the decision to terminate their *long-term investment* by sale, * * * in reality only a step in the process of sale." (App. p. 9)

The impact of this decision, if it is permitted to stand, will have a serious repercussion upon the effectiveness of Section 16(b) of the Act and will open the door to successful evasion of its salutary provisions in the very area which Congress thought was in most need of regulation.

For, under the rationale of the decision below, every acquisition of an issuer's security by an insider through his exercise of an option or conversion of stock would automatically be excluded from the operation of the statute where the insider has owned such option or convertible security for more than six months. The possession of a backlog of such "long-term" options or convertible securities would thus enable the insider to engage in short-swing transactions and use his inside information with impunity, completely immunizing him against the statutory liability for his profits.

II.

The Decision Conflicts With the Decisions by the Courts of Appeals of Other Circuits.

The decision by the Court of Appeals, that a controlling insider's voluntary conversion of his "long-term investment" in his issuer's Common Stock does not constitute a "purchase" under Section 16(b) of the dividend-preferred shares acquired by him thereby, conflicts with the decisions on the same point by the Courts of Appeals for the First and Second Circuits.

In *Park & Tilford, Inc. v. Schulte* (2 C.A.), 160 F. 2d 984, *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255, and *Booth v. Varian Associates, Inc.* (1 C.A.), 334 F. 2d 1, the Courts of Appeals held in each of such cases that an insider's conversion of his issuer preferred stock into common stock constituted a "purchase" of the latter shares acquired thereby within the purpose and meaning of Section 16(b), although the preferred stock had been owned by the insider for several years prior to its conversion. Moreover, in each of these cases, the insider raised and thoroughly argued the point of his "long-term investment" of his preferred stock, but the Courts refused to sustain such argument.

In view of such conflicting opinions, this important area of the law now becomes almost ludicrously uncertain. Unless such uncertainty is settled by this Court, the administration and enforcement of the statute will be diluted to such an extent that its continued existence will become meaningless.

Conclusion.

For the foregoing reasons, this petition for a writ of Certiorari should be granted.

Respectfully submitted,

KENNY, MORRIS & IBANEZ, and
MORRIS J. LEVY,
Counsel for Petitioner, Blau.

APPENDIX.

Statutes.

Sections 16(a) and Section (b) of the Securities Exchange Act of 1934, 15 U.S.C.A., Sects. 78p(a) and 78p(b), provide as follows:

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78 (g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such months, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by rea-

son of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 3(a)(13) of the Securities Exchange Act of 1934, 15 U.S.C.A., Sect. 78c(a)(13), provides as follows:

"The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Isadore Blau, Appellant, vs. Max Factor & Company, et al., Appellees. No. 19,202.

[Feb. 24, 1965]

Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Barnes, Hamley, and Browning, Circuit Judges.

Browning, Circuit Judge:

Appellant, a stockholder of Max Factor & Co., brought this action under section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78p(b),[1] to

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[1]Sec. 16(b) reads:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer . . . in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or

recover, on behalf of the corporation, profits said to have been realized by corporate insiders in a short-swing speculation in the company's Class A stock. The district court granted appellees' motion for summary judgment. We affirm.

Prior to 1947 Max Factor & Co. was a family corporation. In that year Max Factor Common stock was offered to the public. Class A stock was issued in the following year. It was created as a part of a plan to permit the company to pay maximum dividends to non-family stockholders while retaining earnings otherwise payable to the family stockholders (the appellees) for use in the business, without exposing the family stockholders to potential tax liability.

The Class A thus created had equal voting powers with the Common, rights on liquidation were the same, neither class was subject to redemption, and both were fully transferable. However, the board of directors was empowered to declare lesser dividends on Common than were declared on Class A.[2] Common was made ex-

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any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Sec. 16(b) applies to the same persons as § 16(a), that is, "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered on a national securities exchange, or who is a director or an officer of the issuer of such security . . ."

For the purpose of their motion for summary judgment, appellees concede that they are members of the class to which § 16-(b) applies.

[2]At all relevant times appellees owned more than 75% of the voting stock, and constituted more than a majority of the board of directors. They were therefore able to determine whether and to what extent the power to declare lesser dividends on their Common would be exercised. Dividends declared on Common were in fact materially below those paid on Class A.

changeable for Class A at any time, and, as had been planned, substantially all of the public stocholders immediately exchanged their Common for Class A, while the appellees retained their Common.

Late in 1960 appellees decided to offer a portion of their stock interest to the public. On March 14, 1961, in contemplation of this public sale and in exercise of the right conferred by the company's certificate of incorporation, they exchanged 200,000 shares of their Common for an equal number of shares of Class A. They sold the latter to the public on April 18, 1961.

The Common involved in the exchange had been acquired by appellees from five to thirty-two years earlier. No appellee acquired Class A within six months of the sale, except by the exchange. This suit was brought to recover the "profit" which resulted from an increase in the market price of Class A during the month between the exchange and sale.

Concededly appellees are corporate insiders of Max Factor & Co., subject to section 16(b). Concededly they made a "sale" of Class A less than six months after acquiring the Class A in exchange for Common. However, the district court concluded that the exchange of Common for Class A was not a "purchase" of the Class A within the meaning of section 16(b). We agree.[3]

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[3]The district court also held that the transaction was excluded from § 16(b) by Securities Exchange Commission Rule 16B-9, issued by the Commission some four months after the filing of this action. Rule 16B-9 purports to exempt from the operation of § 16(b) the exchange of shares of one class of stock for shares of another of the same corporation, pursuant to a right of conversion granted by the company's charter, if (1) the classes of shares exchanged evidence substantially the same rights and privileges except that the board of directors may declare a lesser

The statutory definitions of "purchase" and "sale" are exceedingly general.[4] They are given specificity by measuring questioned transactions against the purpose of section 16(b). Thus, a transaction is held to be a "purchase" within section 16(b) "if in any way it lends itself to the accomplishment of what the statute is designed to prevent." *Blau v. Lehman*, 286 F.2d 786, 792 (2d Cir. 1960), aff'd 368 U.S. 403 (1962). See also *Park & Tilford v. Schulte*, 160 F.2d 984 (2d Cir. 1947). On the other hand, to avoid purposeless harshness, a transaction is held not to be a section 16(b) "purchase" if it "was not one that could have lent itself to the practices which Section 16(b) was enacted to prevent." *Ferraiolo v. Newman*, 259 F.2d 342, 346 (6th Cir. 1958). See also *Roberts v. Eaton*, 212 F.2d 82, 85-86 (2d Cir. 1954); *Shaw v. Dreyfus*, 172 F.2d 140, 142 (2d Cir. 1949). *Cf. Blau v. Mission Corp.*, 212 F.2d 77, 80 (2d Cir. 1954) ("sale"); *Falco v. Donner Foundation*, 208 F.2d 600, 604 (2d Cir. 1953).[5]

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dividend on the class surrendered than on that acquired; and (2) the exchange was effected in contemplation of a public sale of the shares acquired. The rule was expressly made retroactive. 17 C.F.R. § 240-16b-9 (1963).

Since we decide that § 16(b) was in any event inapplicable, we do not consider the applicability and validity of Rule 16B-9.

[4]Sec. 3(a)(13), 15 U.S.C.A. § 78c(a)(13) provides: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire."

Sec. 3(a)(14), 15 U.S.C.A. § 78c(a)(14) provides: "The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

[5]It has been suggested that as to conversions the statute should be applied broadly, "leaving it to the Securities and Exchange Commission to make appropriate exemption for transactions which fall within the letter of the statute but not its spirit." Meeker & Cooney, 45 Va.L.Rev. 949, 964-65 (1959). However, the primary duty of administering § 16(b), unlike other provisions of the Act, is not imposed upon the Commission, but upon the courts through the medium of stockholder suits. Moreover, the

The initial inquiry must therefore be: What is the purpose of section 16(b)—what practices is the statute designed to prevent?

As section 16(b) itself states, its general purpose is to preclude the "unfair use of information which may have been obtained by" corporate insiders, in trading in the securities of their corporation. But Congress did not seek to accomplish the whole of this purpose by section 16(b) alone. Section 16(b) creates a special remedy, applicable only in a limited situation. Absolute liability is imposed,[6] but only when the insider both acquires and disposes of securities of his corporation "within any period of less than six months." When acquisition and disposition are separated by a longer period, section 16(b) is inapplicable; other remedies are then available, but only upon proof of actual wrongdoing.[7]

The fact that section 16(b) was intended to apply only to insider "short-term speculative swings" is con-

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Commission has been slow to exercise its power of exemption. In these circumstances, whether § 16(b) is to have a flexible or mechanistic application in practice must depend upon the courts.

[6]The insider is required to relinquish his profits, even though he did not enter into the stock transactions with the intention of speculating, and did not utilize, or even possess, confidential corporate information. See Babbitt Inc. v. Lachner, 332 F.2d 255, 257 (2d Cir. 1964); Rheem Mfg. Co. v. Rheem, 295 F.2d 473, 475 (9th Cir. 1961); Blau v. Lehman, 286 F.2d 786, 791 (2d Cir. 1960), aff'd 368 U.S. 403 (1962); Smolowe v. Delendo Corp., 136 F.2d 231, 235-36 (2d Cir. 1943); Comment, 11 Stan. L.Rev. 358 (1959); Meeker & Cooney, 45 Va.L.Rev. 949, 951-52 (1959); Yourd, 38 Mich.L.Rev. 133, 145 (1939); 2 Loss, Securities Regulation 1041 (2d ed. 1961).

[7]See generally, 2 Loss, Securities Regulation 1123-24 (2d ed. 1961); 3 Loss, Securities Regulation, 1455-74 (2d ed. 1961); Yourd, 38 Mich. L.Rev. 133, 139-43 (1939).

firmed by legislative history,[8] and has been often remarked by the courts.[9]

The reasons which led Congress to declare insider profits on stock transactions forfeit only when purchase and sale both occurred within less than six months, though not spelled out in the legislative materials, are nonetheless clear. Improper use of inside information by corporate insiders is most likely to occur in short-term, in-and-out trading. The temptation to trade upon inside information is enhanced when the period for which capital must be committed is short. And ordinarily the useful life of "confidential" inside information is brief.[10] The evidence upon which Congress acted indicated that the abuse occurred almost entirely in short-swing transactions. Moreover, few if any reasons could be advanced for encouraging such trading by insiders. On the other hand, in long-term investment the risk of abuse of inside information was relatively slight, and the affirmative value of long-term personal financial commitments by insiders to the prosperity of the com-

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[8]See particularly, Stock Exchange Practices, Hearings before the Senate Committee on Banking and Currency, 73rd Cong., 1st Sess., pt. 15 at 6557-58 (1934).

[9]Babbitt Inc. v. Lachner, 332 F.2d 255, 257-58 (2d Cir. 1964); Kornfeld v. Eaton, 327 F.2d 263, 264-65 (2d Cir. 1964); Rheem Mfg. Co. v. Rheem, 295 F.2d 473, 475 (9th Cir. 1961); Blau v. Lehman, 286 F.2d 786, 792 (2d Cir. 1960), aff'd 368 U.S. 403 (1962); Ferraiolo v. Newman, 259 F.2d 342, 344 (6th Cir. 1958); Roberts v. Eaton, 212 F.2d 82, 85 (2d Cir. 1954); Shaw v. Dreyfus, 172 F.2d 140, 142 (2d Cir. 1949).

[10]As the Commission has pointed out, "In and out trading greatly magnifies the possibility of profit from inside information in relation to a given amount of capital and makes such profit [all] the more unfair because of the relatively risk-free character of a short-term commitment which the insider may make in anticipation of a favorable market development." Securities Exchange Act Release No. 4509 (1950), CCH Fed. Sec. L. Rep. '48-'52 Decision, par. 76080.

panies which they controlled was obviously great. Thus, by basing forfeiture of profits upon the length of the insider's investment commitment, Congress sought to minimize misuse of confidential information, without unduly discouraging bona fide long-term investment.[11]

Appellees' investment commitment in Max Factor & Co. was a long term one, undertaken, as we have noted, many years prior to their exchange of Common for Class A. The exchange of Class A for Common did not interrupt the continuity of appellees' investment: it did not increase or decrease the amount invested, or alter in any way the risk assumed long years before. Moreover, since there was no speculative advantage in holding Class A rather than Common, the exchange conferred no opportunity for speculative profit which appellees did not already enjoy. Thus, appellees made only one investment decision in the six months' period—the decision to terminate their long-term investment by sale.[12] The exchange was in reality only a step in the process of sale—and an unnecessary one at that, for Common was as marketable as Class A and at precisely the same price.[13]

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[11]Securities Exchange Act Release No. 4509 (1950), CCH Fed. Sec. L. Rep. '48-'52 Decisions, par. 76080, quoted in part in Kornfeld v. Eaton, 217 F.Supp. 671, 767-77 (S.D.N.Y. 1963); Roberts v. Eaton, 212 F.2d 82, 85 (2d Cir. 1954); Steinberg v. Sharpe, 95 F.Supp. 32, 34 (S.D.N.Y. 1950), aff'd on opinion below 190 F.2d 82 (2d Cir. 1951); Truncale v. Blumberg, 88 F.Supp. 677, 679 (S.D.N.Y. 1950), aff'd on opinion below, sub nom. Truncale v. Scully, 182 F.2d 1021 (2d Cir. 1950); Note, 63 Colum.L.Rev. 1518, 1521 (1963); Meeker & Cooney, 45 Va. L.Rev. 949, 963-64 (1959); Comment, 59 Yale L.J. 510, 511 (1950); Hardee, 65 Harv.L.Rev. 997, 1007 (1952).

[12]Cf. Blau v. Ogsbury, 210 F.2d 426 (2d Cir. 1954).

[13]Class A was registered or "listed" on a national exchange under the Securities Exchange Act of 1934, and Common was not, but all shares of Class A issuable for exchange for out-

Thus, the making of the exchange, and its timing, were simply irrelevant to the use of insider information in short-term speculation—the problem with which section 16(b) is concerned. If appellees acted upon inside information in disposing of their stock interest when they did, the exchange was unrelated to that fact—they could have done so quite as well, at exactly the same time, realizing precisely the same profit, without converting their Common to Class A at all. So also the nature, duration ,and amount of their investment, the temptation and opportunity to trade on inside information, and the profit to be had by doing so, would all have been the same had the exchange been accomplished six months or more before the sale. In these circumstances, to hold that the exchange of Common for Class A constituted a "purchase" within section 16(b) would ignore the distinction which Congress drew between long-term investment and short-term speculation.

Appellant places primary reliance upon *Park & Tilford v. Schulte,* 160 F.2d 984 (2d Cir. 1947). While the broad language of the opinion in that case would

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standing shares of Common were also registered on the national securities exchange for listing on notice of issuance. Since there was an unrestricted right to exchange Common for Class A share for share at any time, and the latter would automatically be listed on the national securities exchange as soon as issued, Common and Class A were equally marketable. The evidence was undisputed that brokers accepted Common for sale at the market price for Class A, completing the exchange before delivery to the purchaser.

When appellees exchanged their Common for Class A, neither were registered (or exempt) under the Securities Act of 1933, and since appellees occupied a "control" relationship to the company, they could not transfer stock of either class to the general public without registering it under the 1933 Act. Since they exchanged their Common for Class A before making a public sale they registered only the Class A, but they might have registered the Common as readily.

support a decision that the appellees' exchange of Common for Class A constituted a section 16(b) "purchase,"[14] the holding does not. The preferred and common exchanged in *Park & Tilford* involved significantly different investment risks. For this and other reasons, the decision to exchange the convertible security required an investment decision within the six months' period distinct from the decision to sell the converted security—a new investment risk was undertaken, and a new, if limited, opportunity was presented to realize profit, or avoid loss, through the use of insider information.[15]

Affirmed.

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[14]Thus the court stated, "Defendants did not own the common stock in question before they exercised their option to convert; they did afterward. Therefore they acquired the stock within the meaning of the Act." 160 F.2d at 987.

[15]Laufer, 8 N.Y.L.F. 232, 243 (1962); Note, 107 U.Pa.L.Rev. 719, 725 n.30 (1959); Note 45 Va.L.Rev. 123, 126 n.19 (1959); Meeker & Cooney, 45 Va.L.Rev. 949, 962-963 (1959); Comment, 59 Yale L.J. 510, 526 (1950). But see Comment 11, Stan.L.Rev. 358, 361-65 (1959).

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IN THE

Supreme Court of the United States

October Term, 1965
No. 140

ISADORE BLAU,

Petitioner,

vs.

DAVIS FACTOR; LOUIS FACTOR; MAX FACTOR, JR., SIDNEY FACTOR; CHESTER FIRESTEIN; MAX FIRESTEIN; FREDA F. SHORE; ANNA FACTOR; DORIS FACTOR; DOROTHY FACTOR; CECILIA FIRESTEIN, and MAX FACTOR & CO.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief for Respondent, Max Factor & Co., In Opposition.

Statement of the Case.

This case is on Petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit, rendered February 24, 1965, which affirmed the judgment of the United States District Court for the Southern District of California, Central Division [R. 143], dismissing the complaints and cross-complaint against the individual respondents herein. The District Court did not render any opinion in

the action. Its Findings of Fact and Conclusions of Law [R. 137] were not officially reported. The opinion of the Court of Appeals for the Ninth Circuit [R. 155, Appendix of Petition, p. 3] is reported at 342 F. 2d 304.

Max Factor & Co. (the "Company") filed its complaint in the court below [No. 63-414 TC; R. 1] on April 8, 1963, in strict compliance with the demand made by petitioner Blau under date of March 5, 1963 [R. 9] for the purpose of obtaining (1) a judicial determination as to whether the transactions referred to in Blau's demand gave rise to any liability under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78p(b), and if so, (2) to recover the profits, if any, realized by certain of the individual respondents within six months from any purchase and sale of equity securities of the Company within the purpose and meaning of Section 16(b).

The District Court correctly determined [R. 140], among other things, that:

> (a) The individual respondents' exchanges of Common for Class A shares of the Company did not constitute "purchases" within the purpose and meaning of Section 16(b); and that
>
> (b) The individual respondents "did not, within the purpose and meaning of Section 16(b) of the Securities and Exchange Act of 1934, 'realize' any profit from any 'purchase and sale' of any stock of Max Factor & Co. within any period of less than six months by reason of the exchanges by them of Common Shares for Class A shares, followed by the sale of Class A Shares."

The decision of the United States Court of Appeals for the Ninth Circuit, in affirming the judgment of the District Court, upheld the foregoing determinations.

Points of Fact and Law Presented.

Reference is made to the Brief in Opposition to the Petition for Writ of Certiorari filed herein on behalf of the individual respondents for a statement of the material facts, pleadings and points of law involved, and citation of authorities and statutes.

Conclusion.

For the reasons asserted, and on the basis of the arguments advanced, on behalf of the individual respondents in their brief in opposition, it is the position of the Company that there are no special or important reasons warranting certiorari; that the decision below of the Ninth Circuit is not in conflict with the decision of any other court of appeals on the same matter nor is it in conflict at all with the Congressional purpose and intent underlying the enactment of Section 16(b); and that the decision below was entirely correct.

Respectfully submitted,

OVERTON, LYMAN & PRINCE,

CARL J. SCHUCK,

WAYNE H. KNIGHT,

Counsel for Respondent,
Max Factor & Co.

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IN THE

Supreme Court of the United States

October Term, 1965
No. 140

ISADORE BLAU,

Petitioner,

vs.

DAVIS FACTOR; LOUIS FACTOR; MAX FACTOR, JR.; SIDNEY FACTOR; CHESTER FIRESTEIN; MAX FIRESTEIN; FREDA F. SHORE; ANNA FACTOR; DORIS FACTOR; DOROTHY FACTOR; CECILIA FIRESTEIN; and MAX FACTOR & Co.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief for Respondents, Davis Factor; Louis Factor; Max Factor, Jr.; Sidney Factor; Chester Firestein; Max Firestein; Freda F. Shore; Anna Factor; Doris Factor; Dorothy Factor; and Cecilia Firestein, in Opposition.

Opinions Below.

The District Court did not render any opinion in the action. Its Findings of Fact and Conclusions of Law appear at R. 137. The opinion of the Court of Appeals for the Ninth Circuit [R. 155, App. of Petition, p. 3] is reported at 342 F. 2d 304.

Jurisdiction.

The jurisdictional requisites are adequately set forth in the Petition.

Question Presented for Review.

"Whether the exchange of shares of one class of stock for another of the same corporation, pursuant to a right of exchange granted by the issuer's charter, constitutes a 'purchase' of the new shares within the meaning of Sections 16(b) and 3(a)(13) of the Securities Exchange Act of 1934, 15 U.S.C. Sections 78p(b) and 78c(a)(13) where:

(a) As concurrently found by two courts below, the investment risk, marketability and market price of both classes are identical;

(b) The rights and privileges of both classes are substantially identical, the sole exception being that the Board of Directors *may* but *need not* declare a lesser dividend on the class surrendered than on that received in the exchange; and

(c) Where, as a result, the two lower courts have found that the making of the exchange, and its timing, were simply irrelevant to the use of inside information."

Statutes and Regulations Involved.

Pertinent provisions of the Securities Exchange Act of 1934, Sections 16(a), 16(b) and 3(a)(13), 15 U.S.C. Sec. 78p(a), p. 46 Cum. Sup., Sec. 78p(b), p. 322, and Sec. 78c(a)(13), p. 235, are set forth in the App. to the Petition, p. 1.

Statement of Facts.

A. The Material Pleadings.

In compliance with the demand dated March 5, 1963 of petitioner Blau [R. 9], Max Factor & Co. ("the company" herein) on April 8, 1963, filed its complaint in the court below (No. 63-414 TC), for the purpose of obtaining a judicial determination whether the transactions referred to in Blau's demand gave rise to liability under Section 16(b) and, if so, for the recovery of any profits realized by certain respondents from any purchase and sale of the equity securities of the company within any period of less than six months [R. 1]. Named as defendants were Blau and, in accordance with his demand, the seven officers or directors of the company referred to therein [R. 1].

After having been served with the company's complaint, petitioner Blau filed a separate action, involving the identical transactions, in the United States District Court for the Southern District of New York, naming as defendants the company and the eleven individual respondents[1] [R. 45]. On motion of respondents, that action was transferred under the provisions of 28 U.S.C. §1404(a) to the United States District Court for the Southern District of California [R. 101].

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[1]The seven male respondents are directors and/or officers of the company; three of the female respondents are neither directors, officers nor owners of ten per cent of the listed securities of the company but are wives of three of the directors; the fourth female respondent is neither a director, an officer, a ten per cent owner of listed securities of the company, nor a wife of a director or officer or such a shareholder. However, in view of petitioner's claim in the District Court that all eleven respondents should be treated as a unit for Section 16(b) purposes, respondents stipulated solely for the purpose of the motions for summary judgment that all eleven respondents were "insiders" to whom Section 16(b) would apply if the transactions were within the scope of the section and were not exempt by reason of Rule 16b-9 [R. 138].

By his answer and cross-claim in the first action, Blau asserted precisely the same claims against respondents as were set forth in an amended complaint by him in the second action [R. 19, 28]. After the filing of answers and supplemental answers to the complaints and cross-claims, the individual respondents filed motions for summary judgment dismissing the complaints and cross-claims. The actions were consolidated, without objection, for the hearing and determination of these motions [R. 137]. The motions were granted on January 27, 1964, and findings of fact, conclusions of law, and judgment were filed and entered on January 28, 1964 [R. 137, 143].

The trial court determined [R. 143, 144] (i) that the challenged transactions did not constitute "purchases" within the purpose and meaning of Section 16(b), (ii) that the individual respondents did not "realize" any profit from any "purchase and sale" of any stock of the company within any period of less than six months, and (iii) that, in any event, the transactions were exempt by reason of the provisions of Rule 16b-9 of the Rules of the Securities and Exchange Commission.

The Court of Appeals affirmed as to points (i) and (ii), but expressly stated that "since we decide that §16(b) was in any event inapplicable, we do not consider the applicability and validity of Rule 16b-9" [App. of Petition, p. 6].[2]

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[2]The Securities and Exchange Commission adopted Rule 16b-9 exempting transactions of the type involved in the present case, pursuant to express authority given the Commission in Section 16(b), which reads, in part, "* * * This subsection shall not be construed to cover * * * any transaction or transactions which the Commission by rules and regulations *may exempt as not comprehended within the purpose of this subsection.* [italics added]" [App. to Petition, p. 2]. In its brief as amicus curiae before

B. The Material Facts.

The individual respondents are the sons and daughters of the founder of the company, Max Factor, Sr. and their close relatives. Prior to 1946, the stock of the company was wholly owned by the Factor family. In 1946, the company first sold its stock to the public. At that time the Common Stock was the only existing class of stock [R. 138].

Shortly thereafter the family members proposed a stock structure which would permit a maximum dividend yield to the nonfamily public stockholders while at the same time permitting the company to retain a large proportion of its earnings to finance the expected expansion of the company [R. 108-109]. In order to accomplish this, the family members were willing to grant to the Board of Directors the right to declare and pay a higher dividend to the public stockholders than it would declare and pay to the family stockholders. This plan was effectuated in 1947 by the creation of Class A Stock by amendment to the company's Certificate of Incorporation. All the then outstanding stock was Common Stock and each holder had the right to exchange his Common Stock for a like number of shares of Class A Stock at any time.

The public stockholders made the exchange soon after the Class A Stock was created, but the family

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the Court of Appeals the Commission argued in support of the District Court's judgment (which was affirmed) and stated that the mere adoption of Rule 16b-9 did not imply that the Commission believed the transactions in the present case are within Section 16(b). "Rules are often adopted as a precaution against possible court decisions to the contrary." Brief of Securities and Exchange Commission as amicus curiae page 5.

members continued to hold their shares as Common Stock for many years. [R. 13, 108-109, 78]. Since 1957, the rights and privileges of the Common Stock and of the Class A Stock of the company are as set forth in Article Fourth of its Certificate of Incorporation[3] [R. 139].

It is significant that the only purpose for the creation of the Class A shares was to permit, but not require, the Board of Directors to declare a lesser (or no) dividend on the Common shares than on the Class A shares. [R. 108-109]. That this is the only difference in the rights and privileges of the two classes of shares is manifest from a reading of Article Fourth (App.). In all other respects the rights and privileges of the two classes are precisely the same. The shares of both classes have equal voting powers. The shares of both classes have equal rights on liquidation. None of the shares is subject to redemption. All of the shares are freely transferable. [R. 13, 80, 138-139]. Indeed, that there are no differences between the two classes of shares is demonstrated by the fact that the Board of Directors may adopt a resolution by virtue of which all outstanding Class A shares shall become shares of Common Stock on a share-for-share basis. [R. 80]. At all times, the company has consistently treated the Common Stock and the Class A stock as if they were shares of a single class of common stock in report-

[3]The provisions of Article FOURTH of the Certificate of Incorporation are set forth in the Appendix.

ing its earnings per share in press releases, in annual reports to shareholders, in its prospectuses, and its reports to the Securities and Exchange Commission. [R. 13].[4]

On the basis of the foregoing facts, the trial court found that the only difference between the rights and privileges of the Common Stock and of the Class A Stock was that the Board of Directors could declare a lesser or no dividend on the Common than was declared or paid on the Class A.

On March 14, 1961, the individual respondents[5] exchanged an aggregate of 200,000 shares of Common Stock which they had owned for many years[6] for 200,000 shares of Class A Stock of the company in accordance with the provisions of the company's Certificate of Incorporation which gave them the right at any time to make such exchange. Such exchanges were made by each individual respondent in contemplation of a public sale of the Class A shares acquired in

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[4]The preceding analysis in the text of the characteristics of the two classes of stock here involved is material to determine whether they are so substantially identical that the exchange of Common for Class A shares followed by the sale of the Class A shares is merely an alternative method of selling the Common. (*Infra*, p. 15).

[5]Not including Chester Firestein, who made similar exchanges of Common for Class A shares and later sold Class A shares [R. 139]. These differences are immaterial to any of the issues presented by the petition.

[6]Three respondents acquired said Common shares in 1929 [R. 71, 75, 77]; one in 1929 and 1938 [R. 67]; one in 1933 [R. 69]; one in 1938 [R. 72]; one in 1946 [R. 74]; and four prior to 1956 [R. 68, 70, 73, 76]. Thus respondents had held this Common Stock for a minimum of five years and a maximum of thirty-two years prior to the exchange in 1961.

the exchange [R. 67-77]. On April 18, 1961, said 200,000 shares of Class A Stock were sold by said respondents to underwriters who resold said shares to the public as part of a public offering described in a registration statement filed pursuant to the Securities Act of 1933 (15 U.S.C. §§77A, *et seq.*) with the Securities and Exchange Commission and which became effective on April 11, 1961 [R. 121, 139]. During the period of less than six months between the dates of the exchanges of Common shares for Class A shares and the dates of the sales of Class A shares, there was substantial rise in the market price of the Class A shares.[7]

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[7]Contrary to Petitioner's assertion (Petition, p. 6) that the increase in the market price of Max Factor stock was extraordinary when compared to other comparable companies, the facts show this: A qualified expert showed that the prices of three comparable stocks increased at approximately the same rate as did the price of Max Factor over the period from December 1960 to April 1961. Mr. Levy, one of petitioner's counsel whose qualifications, if any, as an expert securities analyst are not contained in this record, shows that stock comparable in his opinion increased during the same period only 68.5%, 76.7%, 52.9%, and 44.1% [R. 133].

ARGUMENT.

The issue in the present case is narrow, and no amount of straining on the part of petitioner can convert it into a case warranting review by this Court on certiorari. The interpretation of Sections 16(b) and 3(a)-(13) of the Securities Exchange Act of 1934 by the Court of Appeals in this case are in accord both with applicable precedent, the language of the statute and the Congressional purpose and intent which prompted the enactment of Section 16(b).

Furthermore, the decision by the Court of Appeals for the Ninth Circuit in this case is not in conflict with the decisions of the Courts of Appeal in *Park & Tilford, Inc. v. Schulte* (2 C.A.), 160 F. 2d 984; *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255; and *Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1.

I.

The Decision Below Is Clearly Correct.

The court below, agreeing with the District Court, determined that the exchange of Common Stock for Class A Stock of the company in this case did not constitute a "purchase" within the meaning and intent of that term as used in Section 16(b). In reaching this conclusion, the court below in its opinion pointed out that the "statutory definitions of 'purchase' and 'sale' are exceedingly general * * *. They are given specificity by measuring questioned transactions against the purpose of Section 16(b). Thus, a transaction is held to be a 'purchase' within Section 16(b) 'if in any way it lends itself to the accomplishment of what the statute is designed to prevent.' *Blau v. Lehman*, 286 F. 2d 786, 792 (2d Cir. 1960), aff'd 368 U.S. 403 (1962)." (App. of Petition, p. 6).

When confronted with a case involving the acquisition of shares, the courts have determined whether it was a "purchase" within the meaning and intent of Section 16(b) by turning to the stated purpose of Section 16(b), viz., "preventing the unfair use of [inside] information," by determining whether the transaction, had the "economic indicia of a purchase" and was thereby one that "could have lent itself to the practices which Section 16(b) was enacted to prevent."[8]

In the *Ferraiolo*[9] case the defendant held convertible fixed-dividend preferred stock which had been called for redemption. He converted the preferred stock into common stock as permitted by the company's Certificate of Incorporation, and in less than six months be sold the common stock at a price higher than the market price of the stock on the date of the conversion. At the time of the conversion the redemption price of the preferred was less than the market price of the common into which it was convertible. It was thus apparent that the defendant, even though possessed with inside information, was in no better position than any other holder of preferred stock in determining whether to convert. If he failed to convert, he would receive the redemption price which was lower than the market price of the common shares into which it was convertible. Therefore, it was obvious to any preferred holder that he should convert rather than to accept the lower redemption price.

In the opinion by Judge (now Mr. Justice) Potter Stewart, the court held that the proper standard to be

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[8]*Ferraiolo v. Newman* (6 C.A.), 259 F. 2d 342, 346, *cert. den.* 359 U.S. 927.

[9]*Ferraiolo v. Newman* (6 C.A.), 259 F. 2d 342, *cert. den.* 359 U.S. 927.

applied was whether "the transaction is of a kind which can possibly lend itself to the speculation encompassed by Section 16(b)." (p. 345) The court then points out that under the circumstances the preferred and common shares were economic equivalents, that the conversion worked no material change in the proportional equity ownership of the company, and concluded:

> "Newman's conversion of Ashland preferred to Ashland common had none of the economic indicia of a purchase; it created no opportunity for profit which had not existed since 1948. The transaction was not one that could have lent itself to the practices which Section 16(b) was enacted to prevent." (p. 346)

For the same reasons, in this case, the date the Common shares were acquired by respondents many years earlier should be treated as the purchase date; and as concluded in its opinion by the court below, the making of the exchange, and its timing, were simply irrelevant to the use of insider information in short-term speculation—the problem with which Section 16(b) is concerned. If respondents acted upon inside information in disposing of their stock interest when they did, the exchange was unrelated to that fact—they could have done so quite as well, at exactly the same time, realizing precisely the same profit, without converting their Common to Class A at all. So also the nature, duration, and amount of their investment, the temptation and opportunity to trade on inside information, and the profit to be had by doing so, would all have been the same had the exchange been accomplished six months or more before the sale. In these circumstances, to hold that the exchange of Common for Class A

constituted a "purchase" within Section 16(b) would ignore the distinction which Congress drew between long-term investment and short-term speculation. (App. to Petition, p. 10).

In *Roberts v. Eaton* (2 C.A.), 212 F. 2d 82, the defendant family members owned substantially all of the stock of the corporation from 1917 until 1947 when they sold a portion of their stock to the public. In 1952, the family owned about 46% of the outstanding $5 par value common stock. In that year, the family decided to sell the remaining stock and determined that its marketability would be improved by reclassification. Accordingly, after approval by the stockholders of such reclassification, defendants surrendered their common stock in exchange for new common and new fixed dividend preferred. Within a month thereafter, they sold the common and preferred. The court held that the exchange did not constitute a "purchase" for 16(b) purposes.

Commenting on *Roberts v. Eaton,* Professor Louis Loss, in his definitive work on the Federal Securities Laws, observed:

> "This, indeed, does seem to be the theme commonly repeated throughout the entire line of unorthodox 'purchase' and 'sale' cases. It is of no more relevance than in routine cash transactions to consider whether inside information was in fact used. But it does seem to be of considerable consequence whether the circumstances were such that the defendant could possibly have obtained an advantage over the public generally which did not already exist. *Cessante ratione cessat ipsa lex.*"
>
> 2 *Loss Securities Regulation* (1961), 1069-1070.

The generally understood meaning of "to purchase" is "to obtain by paying money or its equivalent; to buy for a price,"[10] or "to acquire something by one's own act or agreement for a price."[11] It involves parting with something of value or incurring some detriment. Neither occurs upon an exchange of the Common for Class A shares of the company, and thus such an exchange is not a *purchase* within its ordinary meaning. As detailed above (p. 7), the two classes have precisely the same rights and privileges except that a lesser (or no) dividend may be paid on the Common than on the Class A Stock. Thus, a shareholder who makes the exchange still possesses after the exchange every right which he had before the exchange. He has given up nothing. He has incurred no detriment. The only consequence of the exchange is to withdraw his authorization to the Board of Directors to declare a lesser, or no, dividend on his shares than on other shares. The two-class structure here involved is no different than one in which there is only one class of stock and some of the shareholders have given the corporation a waiver of dividends at the discretion of the Board of Directors, which waiver is revocable by the shareholder at any time. By his act of exchange of Common for Class A, a shareholder of the company simply terminates his pre-existing contingent waiver of dividends. Clearly, the revocation of such a waiver, pursuant to a right reserved in the waiver to do so, is not in any sense the acquisition of anything for a price and, accordingly, is not a *purchase*.

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[10] *Webster's New International Dictionary*, Unabridged, Second Edition, p. 2015.

[11] *Shaw v. Dreyfus* (2nd Cir. 1949), 172 F. 2d 140, 142, *cert. den.* 337 U.S. 907, 92 L. Ed. 1719.

Similarly, in the sense that the term *purchase* always contemplates the acquisition of something for a consideration, an acquisition of a share of Class A for a share of Common Stock is not comprehended within the term. Such a shareholder has lost absolutely nothing by terminating his pre-existing contingent waiver of dividends. As a holder of Class A Stock, he holds each and every right he held as a holder of the Common Stock.

The pertinent statute provides that ". . . unless the context otherwise requires—" the term "purchase" includes "any contract to buy, purchase, or otherwise acquire."[12]

Can it be said that the exercise of an exchange privilege embodied in the corporate charter constitutes a "contract to . . . acquire" made at the time of the exchange? A negative answer is required because the only contract to acquire was made when the common shares were purchased. Under the company's Certificate of Incorporation the holder of Common shares at the time he acquires such Common shares thereby possesses all the rights and privileges inherent in the Class A Stock and all rights to withdraw the contingent waiver of dividends at any time by exchanging his Common for Class A Stock. Thus, the "contract" is made when the Common shares are acquired and there is no contract made at the time of the exchange and no consideration is given at that time. The entire consideration was given at the time the shareholder acquired his Common Stock. The Common shareholder *purchases* the Class A Stock, in the sense of making a "contract to . . . acquire"

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[12]Securities Exchange Act of 1934, Section 3(a)(13), 15 U.S.C. Section 78c(a)(13), (App. to Petition, p. 1)

when he first acquires his shares of Common Stock. Here, respondents purchased their Common Stock in some cases as much as thirty-two years and in no case less than five years before the sale of the Class A Stock. (See f.n. 6 *supra*, p. 7.)

Basically, no *purchase* takes place if the shares exchanged are the economic equivalents of each other. That they are here is manifest, not only from the fact that the rights and privileges of the two classes of shares are identical with the sole exception of the contingent waiver of dividends evidenced by the Common, but also from the practical standpoint that in the market place there was no difference whatever since the purchaser of Common could immediately or at any time exchange it for Class A. In practice, and as pointed out by the court below (App. to Petition, p. 10), Common stock was acceptable to brokers to fill orders to sell Class A stock [R. 94-95].

Petitioner strives to create an alleged difference between the rights and privileges evidenced by the two classes of shares by asserting that the Class A Stock is, and the Common Stock is not, listed on a national securities exchange (Petition, p. 2).

It is true that the issued and outstanding Class A Stock of the company was listed on a national securities exchange [R. 3, 29, 14, 49]. It is also true that all shares of Class A Stock issuable upon exchange for outstanding shares of Common Stock on a share-for-share basis were at all times registered on such national securities exchange for listing thereon upon the giving to such exchange of official notice of issuance thereof [R. 14].

Since the holder of Common shares had an unrestricted right at all times to exchange his Common shares for Class A shares, which would automatically become listed, this can hardly be claimed to be a restriction on the marketability of the Common shares.

As pointed out by the court below, "the exchange was in reality only a step in the process of sale—and an unnecessary one at that, for Common was as marketable as Class A and at precisely the same price." (App. to Petition, p. 9).

The court below correctly pointed out that the only investment decision which was made by the individual respondents in the six-month period was the decision to terminate their long-term investment by sale to the public (App. to Petition, p. 9). The court below (App. to Petition, p. 10), further correctly considered the distinction which Congress made in enacting Section 16(b) between long-term investment, such as involved in this case, and short-swing trading which lends itself to abuse by insiders using inside information.[13]

The court below correctly concluded that the exchange in question was not a "purchase" within the purpose and meaning of Section 16(b) because "it did not increase or decrease the amount invested, or alter in any way the risk assumed long years before." (App. to Petition, p. 9).

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[13]See Stock Exchange Practices, Hearings before The Senate Committee on Banking and Currency, 73rd Cong., First Sess., pt. 15 at 6557-58 (1934).

II.

There Is No Conflict of Decision.

Petitioner asserts that the decision in the instant case is contrary to the decisions of the Court of Appeals in *Park & Tilford, Inc. v. Schulte* (2 C.A.), 160 F. 2d 984; *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255 and *Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1. This is incorrect.

In *Park & Tilford* the defendant had converted shares of fixed-dividend, redeemable, convertible preferred stock after that stock had been called for redemption and thereafter within six months had sold the common stock received upon the conversion. The court, without detailed analysis, asserted that a "purchase" had occurred on such conversion because defendant had not owned the common stock before the conversion but had owned it afterwards.

Even assuming that the conversion in *Park & Tilford* had sufficient "economic indicia of a purchase" so as to come within the ambit of the term as used in Section 16(b), the exchanges of Max Factor stock had no such indicia.

(a) In *Park & Tilford*, substantial differences in rights and privileges existed between the convertible fixed-dividend, redeemable preferred stock and the common stock. Most importantly, (i) the preferred was entitled to a first preference on liquidation and (ii) was subject to redemption thus subjecting the holder to the possibility of complete elimination of his interest in

the company. In the present case the rights and privileges of the two classes of stock are substantially the same.

(b) Not only was the preferred stock in *Park & Tilford* redeemable, but *it had in fact been called for redemption,* which made it both legally and practically necessary for the shareholder to elect within a limited period whether to convert or to be eliminated entirely as a shareholder by suffering redemption. This is a critical factor, for, being insiders, the defendants in those cases were in a position to use their inside information, if any, to make this necessary decision. Thus, if their inside information indicated a rise in the market price of the common, they would convert; otherwise, they would take the redemption price. Other shareholders would have to make this decision without the benefit of such information. In the instant situation, no right of redemption existed,[14] the Common could be exchanged at any time, and no amount of inside knowledge would enable an "insider" to determine any better than any other shareholder a profitable time to make an exchange. The *making* of the exchange or the time it was made would have *no* effect on the profit realized.

(c) The defendant shareholders in *Park & Tilford* had a different proportional interest in the issuer be-

[14]Petitioner strains desperately for a parallel between this case and *Park & Tilford* by asserting that the Class A shares are clothed "with all the attributes of a 'Callable Preferred' stock". (Petition, p. 5) This is totally wrong. The central characteristics of a callable preferred are that the company has a legal right to buy the stock from the shareholder at a price (the redemption or call price) agreed upon in advance and thus can, by calling the stock, completely eliminate the holder's interest as a shareholder. Here, a resolution changing the Class A shares to Common shares would leave each holder with exactly the same rights and privileges, as a holder of the one class of Common shares then outstanding, as he had before the change. Far from having "all the attributes of a 'Callable Preferred' ", the Class A shares have none of such attributes.

fore and after the conversion of preferred (with fixed dividend, fixed redemption, and fixed liquidation rights) into common (with all the residual dividend and liquidation rights). In the Max Factor situation the proportional interests were identical before and after the exchange of Common for Class A.

The court below considered Petitioner's argument that *Park & Tilford* is controlling in this case and distinguished that case as follows: "The preferred and common exchanged in *Park & Tilford* involved significantly different investment risks. For this and other reasons, the decision to exchange the convertible security required an investment decision within the six months' period distinct from the decision to sell the converted security—a new investment risk was undertaken, and a new, if limited, opportunity was presented to realize profit, or avoid loss, through the use of insider information" (App. to Petition, p. 11).

In the *Babbitt*[15] case, the Court of Appeals' abrupt conclusion (p. 258) "that a conversion of preferred into common is a 'purchase' within the meaning of §16(b)," citing the *Park & Tilford* case is dictum because the court concluded that no profit existed on any transaction involving the conversion of the Series "B" Preferred Stock into common. Moreover, there is nothing in the opinion which would indicate what the relative rights and privileges of the Series "B" Preferred Stock, and the Common were other than the statement (p. 258) that Series "B" Preferred, unlike Common, had no market. In this respect, the *Babbitt* case is clearly distinguishable from the instant case where the Common does have a ready market

[15] *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255.

(*supra*, p 15). In short, the *Babbitt* case is clearly distinguishable and any alleged conflict between the decision in that case and the decision in the court below is illusory.

In the *Booth*[16] case, the Court of Appeals was concerned with the question whether the acquisition of shares in 1962 pursuant to a binding executory agreement entered into in 1959, was a "purchase" in 1962 for the purpose of Section 16(b). The Court of Appeals concluded that the acquisition of the shares in 1962 was a "purchase" for the purpose of Section 16(b). The fact situation in that case is not comparable to this case[17] nor is the rationale of the *Booth* opinion in conflict with the decision in the court below.[18] In fact, the Court of Appeals in the *Booth* case stated that both sides had relied to a great extent upon cases concerned with the application of Section 16(b) to options, warrants, conversions and like transactions and referred, among other things, to *Roberts v. Eaton* (discussed *supra* at p. 12) and the *Park & Tilford*

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[16]*Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1.

[17]The defendants in *Booth* sold their shares of Bomarc to Varian in 1959 in return for a promise by Varian to deliver Varian shares in 1962 based on the 1962 market price for Varian stock. The question was not whether the acquisition of the Varian shares was a "purchase" but when did the "purchase" take place, *i.e.*, 1959 when the agreement was entered into or 1962 when the number of shares was fixed and the shares were delivered.

[18]The decision in the *Booth* case is based to a large extent on the argument that the use of a 1959 purchase date would perhaps bar any recovery under the applicable statute of limitations. Moreover, the *Booth* opinion is based on the rationale that since the price per share was not fixed until 1962, no short-swing speculation could have taken place in 1959 with respect to the shares to be acquired by defendants under the 1959 agreement. *Booth v. Varian Associates* (1 C.A.), 334 F. 2d 1, 4-5.

case (discussed *supra* at p. 17). The court in the *Booth* case concluded that "we do not believe cases of the classes referred to, involving problems peculiar to their own types of transactions, are especially helpful in deciding the case before us." The Petitioner's attempt to rely on the *Booth* case as authority contrary to the decision of the court below in this case is similarly unhelpful to this court.

III.

There Is No Important Question of Federal Law Involved.

Petitioner misstates the impact and rationale of the decision below in an attempt to convince this Court that the decision below has a wider impact on the application of Section 16(b) than it actually has. Petitioner states that "under the rationale of the decision below, every acquisition of an issuer's security by an insider through his exercise of an option or conversion of stock would automatically be excluded from the operation of the statute where the insider has owned such option or convertible security for more than six months." (Petition, p. 11). The court below has not, in any way, purported to state that every acquisition of stock by an insider through the exercise of an option or conversion of stock held for more than six months would automatically be excluded from the operation of the statute. The decision of the court below is based upon the fact that the Class A and Common Stock of the company are virtually identical and the "exchange of Class A for Common did not interrupt the continuity of appellees' investment: it did not increase or decrease the amount invested, or alter in any way the risk assumed long years before." (App. to

Petition, p. 9). The exercise of an option (involving typically the payment of cash or a promissory note in return for stock) results in a substantial change in the investment risk undertaken by the optionee and, for that reason, it is not akin to the exchange of Max Factor Common Stock for Class A Stock. The opinion of the court below is clearly limited in its applicability to the type of transaction where the exchange of shares is a matter of form rather than substance (See App. to Petition, footnote 13, on pages 9-10). As such, the decision below is not only correct, but clear, and the question involved, while of substantial importance to the parties, is limited and does not involve a question with which this Court should concern itself.[19] As pointed out above, the opinion below is not in conflict with the opinions referred to by Petitioner on page 12 of the Petition and it does not render uncertain the enforcement of Section 16(b) of the Securities Exchange Act of 1934.

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[19]Moreover, a decision by this Court on the issue presented by the Petition would not dispose of the case or the legal issue of the applicability of Section 16(b) to an exchange of the type here in question, for, as mentioned *supra*, at page 4, the District Court found that the exchange in question was exempted by Rule 16b-9 of the Securities and Exchange Commission [R. 143, 144]. The Court of Appeals expressly declined to reach that question since it concluded that the exchange was not a "purchase" under the Statute (App. to Petition, p. 6). In these circumstances, a reversal by this Court would result in a remand to the Court of Appeals to review the District Court's decision concerning Rule 16b-9 and the issue of the applicability of Section 16(b) to an exchange of the Max Factor type would remain.

Conclusion.

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX.

Excerpt From Certificate of Incorporation of Max Factor & Co. Setting Forth the Rights and Privileges of the Common Stock and Class A Stock.

FOURTH: The total number of shares of all classes of stock which the corporation is authorized to issue is fourteen million (14,000,000). All such shares are to have a par value of one dollar ($1.00) and are to be divided into two (2) classes to be known, respectively, as "Class A Stock" and "Common Stock." The number of shares of Class A stock shall be ten million (10,000,000) and the number of shares of Common stock shall be four million (4,000,000).

The designations and the powers, preferences and rights, and the qualifications, limitations and restrictions thereof, of the various classes of stock of the corporation are as follows:

Commencing April 1, 1958, and with respect to each quarterly period commencing on the first day of April, July, October and January in each year, the holders of Class A Stock shall be entitled, when and as declared by the Board of Directors, to dividends at such rate as may be determined by the Board of Directors payable in preference and priority to any payment of any dividend on shares of Common Stock. After a dividend with respect to any quarterly period has been so paid or declared and set apart for payment on the Class A Stock, a dividend for such period may be paid or declared and set apart for payment on each share of Common Stock equal to or less than such dividend on each share of Class A

Stock for the same quarterly period. The right to such dividends shall not be cumulative and no right shall accrue to any holder of either class of stock by reason of the fact that dividends on said shares are not paid with respect to any quarterly period.

The holders of stock of each class shall be entitled to one (1) vote for each share of stock held by them and voting shall not be by separate classes except where specifically so required by law.

Common Stock at the election of the holders thereof may be exchanged share for share for Class A Stock at any time prior to but not on or after a date which may be specified by resolution of the Board of Directors as the date on or before which the Class A Stock must be exchanged share for share for Common Stock as hereinafter provided.

At any time on or after January 1, 1950, the directors may, by resolution, require that the Class A Stock be exchanged share for share for Common Stock on or before a date specified by the directors, which date shall be not earlier than ten (10) days and not later than forty (40) days after the mailing of notice of the adoption of such resolution to the holders of record of Class A Stock, directed to them at their respective addresses for Notice of Stockholders' Meetings in accordance with the by-laws of the corporation. The holders of Class A Stock shall surrender their certificates therefor to the corporation on or before said date and shall receive in exchange therefor certificates for a like number of shares of Common

Stock. The issued number of shares of Common Stock shall be increased by the number of Class A shares exchanged. After said date the shares of Class A Stock shall not be deemed to be outstanding for any purpose whatsoever and the respective holders thereof shall have no further rights or claims against the corporation, except the right to surrender their certificates and to receive in exchange certificates of Common Stock, together with an amount equal to any dividends which may have been declared on the Common Stock to holders of record of the Common Stock on or after the date specified by the Board of Directors for exchange of Class A Stock for the Common Stock.

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IN THE

Supreme Court of the United States

October Term, 1965

No. 140

ISADORE BLAU,

Petitioner,

vs.

DAVIS FACTOR, LOUIS FACTOR, MAX FACTOR, JR., SIDNEY FACTOR, CHESTER FIRESTEIN, MAX FIRESTEIN, FREDA F. SHORE, ANNA FACTOR, DORIS FACTOR, DOROTHY FACTOR, CECILIA FIRESTEIN, and MAX FACTOR & CO.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Reply Brief in Support of Petition for Certiorari.

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Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Reply Brief in Support of Petition for Certiorari.

I.

The Respondents Effected a "Purchase" of Class A Shares on the Date They Exchanged Their Convertible Common Stock Therefor.

In paraphrasing the basic concept of the Court's opinion below, the respondents contend at page 11 of their brief that, since they had initially acquired their issuer's convertible Common shares "many years earlier", the date upon which they acquired *such* shares "should be treated as the purchase date" of the *Class A stock*

which they subsequently received in exchange therefor. Continuing this argument the respondents further urge that, since the sales of their *Class A stock* (concededly made *less than* six months subsequent to its acquisitions), were effected more than six months after they had purchased their *convertible Common shares,* "the making of the exchange, and its timing, were simply irrelevant to the use of insider information in short-term speculation" even "if respondents acted upon inside information in disposing of their (Class A) stock interest when they did."

Although conceding that the statutory definition of "purchase" *expressly includes* "any contract to buy, purchase, or otherwise acquire",[1] the respondents attempt to amplify their argument at page 14 of their brief by asserting that "there is no contract made at the time of the exchange"; and "the only contract to acquire (the Class A stock) was made when the (convertible) Common shares were purchased."

This argument is completely unsound, however, for the following reasons:

While it is true that the ownership of the issuer's convertible Common stock carried with it an *option* which granted the right *to ask for and receive* Class A shares in exchange therefor, such an option merely constituted an irrevocable *offer* by the issuer which could only ripen into a legally binding "contract" when *accepted and acted* upon by its owners. Obviously the issuer was not legally bound to issue its Class A stock in exchange for convertible Common *until such time* as

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[1]Section 3(a)(13) of the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78(c)(13).

the respondents decided to exercise their option and request it, thereby converting such option into a valid contract.

By attributing the dates of their initial convertible Common stock purchases to their subsequent Class A acquisitions, respondents have failed to recognize the legal distinction between their former *executory rights* to acquire such Class A shares and their subsequent voluntary actions required to mature such rights into a valid and binding "contract" to acquire those securities.

The identical argument was raised in *Park & Tilford, Inc. v. Schulte* (2 C.A.), 160 F. 2d 984, where the Court brushed it aside with the observation (at p. 987) that

> "Defendants did not own the common stock in question before they exercised their option to convert; they did afterward. Therefore they acquired the stock within the meaning of the Act. The Act certainly applies as well to executed acquisitions as to executory contracts to acquire."

The same argument was also raised and answered in the same way in *B. T. Babbitt, Inc. v. Lachner* (2 C.A.), 332 F. 2d 255, at p. 258.[2]

The *rationale* in all these cases was based upon the proposition that when an insider converts one class of his issuer's stock into another, it is *his own voluntary action* in exercising his option to convert which determines the actual date of his acquisition of the security

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[2]To the same effect see also, *Heli-Coil Corp. v. Webster* (D.C. New Jersey 1965), 222 F. Supp. 831; *Petteys v. Northwest Airlines, Inc.* (D.C. Minnesota, Fourth Division). The opinion in this case, which was rendered on August 4, 1965, has not yet been reported.

received by the exchange. Accordingly, he may time the exercise of his option to give him the greatest leverage for using his inside information in short-term speculation, thus creating for himself the very opportunity which the statute was designed to correct.

II.

Economic Equivalence of Two Separate Classes of Stock Is Completely Immaterial to Any Determination of the Statutory "Purchase".

The respondents argue at page 15 of their brief that "Basically, no *purchase* takes place if the shares exchanged are the economic equivalents of each other."

This argument is unsound for the following reasons:

Firstly, the provisions of Section 16(b) of the Act fails to make any such distinction since obviously the same avenues for utilizing inside information are equally available to the insider in either instance, and he may time his conversion to make the best use of such information in any case.

Obviously, "economic equivalence" can hardly form the true and determinative test for the statutory "purchase" because in almost every instance, where a convertible security may be exchanged into another class of stock, the market price of the former will normally tend to be tied to and the economic equivalent of the latter. Unless that were so, it would hardly ever be worth while for a shareholder to exercise his conversion privilege.

Secondly, since the option to convert lies completely within the *voluntary* discretion of the owner of the con-

vertible security, his exercise of such right of conversion is no different than if he had purchased for cash in the open market the very security which he could acquire through his voluntary exercise of his conversion privilege. In fact, such an insider's acquisition through the latter means would afford him an even greater opportunity to misuse his inside information through short-term speculation than if he had to effect such purchase for cash because he has not increased his original investment risk until he is sure that it is safe and profitable to do so.

Although the respondents seek to minimize the substantial difference between the convertible Common and the Class A stock, as owners of the convertible security their right to payment of dividends thereon was *legally limited* by express provisions of the issuer's Charter [R. 80]. And, while it is true that the conversion privilege gave them the right to *ultimately* attain the dividend preference of the Class A shares, the respondents' *affirmative action* in converting their Common shares was a necessary prerequisite therefor.

Moreover, it seems altogether preposterous to categorize the convertible Common and Class A stock as "equivalents" in view of the distinct intrinsic differences which would naturally affect the public marketability of each. For assuredly, any normal public investor would prefer to purchase a fully listed, dividend-preferred Class A security, rather than an unlisted, unregistered, limited-dividend convertible Common stock. And this would be true despite the fact that the convertible share were freely exchangeable into Class A stock.

Thus, it is wholly conceivable that a public investor might purchase the convertible security a day or two before the record date for the payment of dividends, and by the time he exercised his conversion privilege he would have lost his right to be paid the higher dividends of the Class A stock. Under such circumstances, he would hardly consider both classes of stock to be "economic equivalents".

Although the argument of "economic equivalence" has repeatedly been raised in other cases, the Courts have refused to be swayed thereby in determining the statutory "purchase".[3]

The respondents seem to argue at page 11 of their brief that their acquisitions of Class A shares ought not be construed a "purchase" under the statute because "the conversion worked no material change in (their) proportional equity ownership of the company".

The obvious inference from this argument is that there can *never* be a "purchase" from the exchange of one class of stock to another unless the insider acquires thereby some *additional* proportional equity interest in the issuer.

The identical argument, however, was rejected in *Roberts v. Eaton* (2 C.A.), 212 F. 2d 82, with the statement (at p. 86) that "we do not think it is alone enough to immunize the transaction from the applica-

[3]See, *Park & Tilford, Inc. v. Schulte* (2 C.A.), *supra; B. T. Babbitt v. Lachner* (2 C.A.), *supra; Heli-Coil Corp. v. Webster, supra; Petteys v. Northwest Airlines, Inc., supra.*

tion of the statute". The Court similarly rejected such argument in *Blau v. Mission Corp.* (2 C.A.), 212 F. 2d 77, cert. denied, 347 U.S. 1016.

The respondents present a further argument at page 13 of their brief, that

> "The two-class structure here involved is no different than one in which there is only one class of stock and some of the shareholders have given the corporation a waiver of dividends * * * which waiver is revocable by the shareholder at any time."

They conclude from this erroneous premise that their act in exchanging the convertible Common for Class A stock merely terminated their "pre-existing contingent waiver of dividends" and, therefore, "is not a *purchase.*"

This argument hardly merits consideration because it is so obviously unsound. If the respondents' arguments were correct, there could never be a "purchase" where the insider exchanged *any* convertible security of his issuer, whether the convertible security paid greater or lesser dividends than the stock into which it were exchangeable. For, in each instance the insider would contend that his act of exchanging his convertible security merely terminated his "pre-existing contingent waiver" with respect to the amount of dividends payable to him by the issuer.

III.

The Question of Federal Law Presented Herein Affects the Rights of Management and Stockholders of Thousands of Public Corporations.

The importance of the issue presented herein is of *continuing* concern to the investment community throughout this land, and is not, as the respondents seem to suggest, limited to the facts in this case.

Moreover its significance has been greatly amplified in view of the recently enacted legislation which has brought thousands of additional *unlisted* public corporations, having outstanding convertible securities, within the purview of Section 16(b) of the Securities Exchange Act of 1934.[4] For, unless the problem here presented is finally determined by this Court the statute will completely lose its effectiveness in the area most subject to abuse, because the courts in the various Circuits will continue to render different opinions in the same situations dependent upon whether their interpretations of the statute are strict or liberal. Such a chaotic condition in this important field of public legislation should not be permitted to exist any longer.

Conclusion.

For the reasons stated above, and in the petition for certiorari, petitioner prays that the petition for certiorari be granted.

Respectfully submitted,

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[4]Secs. 12(g) and 16(a), Securities Exchange Act of 1934, as amended in 1964; 15 U.S.C.A. Secs. 78L(g) and 78p(a).